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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
AMERICAN TELEPHONE AND TELEGRAPH COMPANY	)	
	)	
Petition for the Establishment of Additional Standards to Govern Study Area Boundary Changes in Connection with the Transfer of Service Territories Between or Among Local Exchange Carriers	)	RM-

PETITION FOR RULEMAKING

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SUMMARY

The Commission's current definition of the term "study area" freezes those boundaries as they existed on November 15, 1984 to control the growth of the Universal Service Fund ("USF") that could otherwise result from study area boundary changes. Nevertheless, the Commission continues to entertain waiver requests involving arms-length sales of exchanges by one LEC to another such carrier. As an outgrowth of the Commission's adoption of price cap regulation for Tier 1 LECs, the volume of sales of high cost exchanges to independent LECs is growing significantly, and can be expected to remain at such levels for some time to come.

Unless the Commission acts to contain their effects, these sales may result in an increase of up to $400 million annually in high cost support subsidies. AT&T therefore requests that the Commission's current criteria for addressing such waivers under a public interest standard be made more specific, to assure that high cost exchanges continue to receive adequate support without unduly increasing the USF burden on access ratepayers. A rulemaking should be initiated to prescribe the additional criteria described in this petition, including requirements that LECs submit detailed informational filings in connection with such sales to demonstrate that the transaction satisfies these standards.

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PETITION FOR RULEMAKING

Pursuant to Section 1.401 of the Commission's Rules, 47 C.F.R. §1.401, American Telephone and Telegraph Company ("AT&T") hereby requests the Commission to initiate a proceeding to establish additional standards to govern modifications in study area boundaries in connection with transfers of service territories between or among local exchange carriers ("LECs").

As demonstrated below, a more comprehensive set of criteria governing these transactions should be adopted to preserve the Commission's objectives in "freezing" the current study area boundaries -- most particularly, to maintain the viability of the Universal Service Fund ("USF"). The Commission has already recognized that its current process for scrutinizing sales of exchanges from one LEC to another on a case-by-case basis through individual waiver requests is not calculated to effectuate the Commission's regulatory goal of containing high cost subsidies to reasonable levels. A rulemaking to prescribe more specific criteria in connection with these sales, and to require submission of detailed informational filings by the LECs to demonstrate whether these standards have been satisfied, would assure that high cost exchanges continue to receive adequate support without unduly increasing the USF burden on access ratepayers.

FACTUAL BACKGROUND

A "study area" is a geographic territory generally composed of a LEC's exchanges located within a single state (or, in some instances, including exchanges located within adjacent states that share a community of interest). The Commission's current definition of the term study area freezes those boundaries as they existed on November 15, 1984.[1] The Commission took this action in response to a recommendation of the Federal-State Joint Board, which had expressed its concern about the potential adverse impact upon the growth of the USF that could result from study area changes.[2]

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1 See 47 C.F.R Part 36, Appendix-Glossary.

2 For example, the Joint Board pointed out that in the absence of this restriction on study area boundaries, carriers could qualify for increased high cost support merely by subdividing their study areas to isolate exchanges with high costs. See MTS and WATS Market

(footnote continued on following page)

In the years immediately following its adoption of the Joint Board's recommendation, the Commission was presented with a relatively limited number of transactions involving arms-length sales of exchanges by one LEC to another such carrier. In such instances, adhering to the prohibition on a change in study area boundaries would require the selling party to continue to report the costs of the transferred exchange, and concomitantly would preclude the acquirer from including those costs in its own study area. To avoid these anomalous results, the Commission evolved a three part test for evaluating LEC requests for waiver of the restriction on changes in study area boundaries. Specifically, these requirements are (a) that the boundary change will have "no adverse effect" on the USF support program, (b) that the state commission(s) having regulatory authority over the transferred exchanges do not oppose the change, and (c) that the change otherwise serves the public interest.[3] As a practical matter, the

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(footnote continued from previous page)

Structure, Amendment of Part 67 of the Commission's rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, Recommended Decision and Order, 49 Fed. Reg. 48325 (1984)(¶ 66), recommendations adopted, Decision and Order, FCC 84-637, released December 28, 1984.

3 See. e.g., U S WEST Communications and Gila River Telecommunications (Joint Petition for Waiver), 7 FCC Rcd. 2161 (1992)("Gila River")(¶ 5); U S WEST Communications, Inc. and Emery County Farmers Union

(footnote continued on following page)

LECs have submitted waiver requests to the Commission only after obtaining state regulatory approvals for the proposed sales. Thus, the Commission's review of these transactions has focused on whether they serve the public interest; a key factor in that analysis is their impact on the USF.

Applying these criteria, the Commission has continued to address waiver requests involving "swaps" or outright sales of telephone exchanges by the LECs. Until recently, the annual number of these transactions was relatively limited.[4] Moreover, in virtually all cases these transactions involved the sale of individual exchanges with only limited numbers of access lines.[5]

(footnote continued from previous page)

<u>Telephone Association (Joint Petition for Waiver)</u>, 7 FCC Rcd. 6076 (1992)("Emery County")(¶ 3).

4 For example, as recently as October 1990 the Common Carrier Bureau reported that during the preceding year it had been required to review only 10 study area changes, resulting both from mergers between affiliated LECs and from sales of telephone exchanges from one unaffiliated LEC to another. <u>See Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board</u>, 5 FCC Rcd. 5974, 5975 (1990)("<u>Part 36 NPRM</u>")(¶ 18).

5 <u>See</u>, <u>e.g.</u>, <u>Gila River</u>, <u>supra</u> (562 access lines); <u>Emery County</u>, <u>supra</u> (788 access lines); <u>Chautauqua & Erie Telephone Corp. and New York Tel. Co. (Joint Petition for Waiver)</u>, 7 FCC Rcd. 6081 (1992)(115 access lines); <u>The Island Telephone Company, Telephone and Data Systems, Inc. and Contel of Maine, Inc.</u>, 7 FCC Rcd. 6382 (1992)("Island Telephone")(368 lines).

However, recent events make it apparent that the volume and magnitude of these transactions is growing significantly, and will continue to remain at such levels for some time to come. As a result of the adoption of the Commission's LEC price cap plan,[6] many carriers subject to incentive regulation have apparently reassessed the desirability of continuing to serve high cost exchanges (especially in rural areas), and appear to have concluded that their interests would best be served by transferring those exchanges (with their associated costs) to other, non-price cap LECs.[7] For example, GTE has announced plans to sell exchanges constituting up to 5 percent, or some 800,000 lines, of its 16 million total domestic access lines in service. U S WEST has publicly stated it plans to sell 45 high cost exchanges, serving a total of 45,000 access lines, in Colorado alone. Similar transfers of high cost rural exchanges to independent LECs have been announced in other states. In all, AT&T estimates that as many as 1,800 exchanges located in high

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[6] <u>See Policies and Rules Concerning Rates for Dominant Carriers</u>, 5 FCC Rcd. 6786 (1990)("LEC Price Cap Order").

[7] <u>See</u>, <u>e.g.</u>, August 6, 1993 <u>ex parte</u> letter from Laura D. Ford, Vice President-Federal Regulatory, U S WEST, Inc. to Kathleen Levitz, Acting Chief-Common Carrier Bureau, in AAD 93-42 <u>et al.</u> (describing U S WEST's program for the "sale of selected exchanges" as one means of accomplishing the "efficiency measures encouraged under price caps").

cost areas may be offered for sale by price cap LECs in the next few years.

These events have been accompanied by a quantum increase both in the number of study area waiver requests, and in the numbers of exchanges and access lines involved in each of those transactions. In July, 1993 alone, the Commission received at least eight new petitions for waiver of the restriction on study area boundaries, representing a total of nineteen LEC applicants.[8] Only one of those petitions concerns the

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8 See U S WEST Communications, Inc. and Mid-Rivers Telephone Cooperative, Inc. (Joint Petition for Waiver), DA 93-851, released August 4, 1993 ("Mid-Rivers"); U S WEST Communications, Inc., Triangle Telephone Cooperative Association, Inc. and Central Montana Communications, Inc. (Joint Petition for Waiver), DA 93-849, released August 4, 1993 ("Triangle/Central Montana"); U S WEST Communications, Inc. and 3 Rivers Telephone Cooperative, Inc. (Joint Petition for Waiver), DA 93-852, released August 4, 1993 ("3 Rivers"); U S WEST Communications, Inc., Copper Valley Telephone Company, Midvale Telephone Exchange and Table Top Telephone Company (Joint Petition for Waiver), DA 93-871, released August 4, 1993 ("Copper Valley/Midvale/Table Top"); U S WEST Communications, Inc., Nemont Telephone Cooperative, Inc., Project Telephone Company, and Valley Telecommunications, Inc. (Joint Petition for Waiver), DA 93-853, released August 4, 1993 ("Nemont/Project/Valley"); U S WEST Communications, Inc., Blackfoot Telephone Cooperative, Inc., and Clark Fork Telecommunications, Inc. (Joint Petition for Waiver), DA 93-854, released August 4, 1993 ("Blackfoot/Clark"); U S WEST Communications, Inc. and Range Telephone Cooperative, Inc. (Joint Petition for Waiver), DA 93-850, released August 4, 1993 ("Range Telephone"); U S WEST Communications, Inc., Range Telephone Cooperative Inc., RT Communications, Inc., Tri-County Telephone Association, Inc., TCT West, and Union Telephone Company (Joint Petition for Waiver), DA 93-978, released August 10, 1993 ("RT et al.").

transfer of a single exchange; the remainder entail sales of from six and to as many as 27 exchanges, located in a total of three states.[9] Several of these transactions, moreover, involve purchases of the affected exchanges by multiple parties.[10]

It is reasonable to expect that these recent petitions will be typical of the magnitude and complexity of future LEC waiver requests. Moreover, in light of the price cap LECs' announced plans to aggressively divest themselves of numerous high cost exchanges, the future volume of waiver petitions is likely to increase even further from the recent level of such filings.[11] Unless the Commission acts to contain the growth of the USF that would result from these transactions, AT&T estimates that

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[9] Compare Range Telephone (one Montana exchange) with Mid-Rivers (six Montana exchanges); Blackfoot/Clark (9 Montana exchanges); 3 Rivers (11 Montana exchanges); Copper Valley/Midvale/Table Top (11 Arizona exchanges); Triangle/Central Montana (13 Montana exchanges); Nemont/Project/Valley (20 Montana exchanges); and RT et al. (27 Wyoming exchanges)

[10] See, e.g., RT et al. (four LEC purchasers); Copper Valley/Midvale/Table Top and Nemont/Project/Valley (three LEC purchasers in each transaction).

[11] Press accounts indicate that the total sale price of the sixty U S WEST rural Montana exchanges described above was $124.8 million, despite the fact that the original cost of those properties was only $118.9 million and their value net of depreciation is only $73.5 million. The willingness of the purchasing LECs to pay such a substantial premium for these exchanges may be due in large part to expectations that these amounts can be recovered through additional high cost subsidies from the USF.

high cost subsidies could be increased by as much as $400 million annually, to a total of over $1.1 billion.

STATEMENT

A RULEMAKING SHOULD BE INITIATED TO PRESCRIBE ADDITIONAL STANDARDS FOR STUDY AREA BOUNDARY CHANGES INVOLVING SALES OR OTHER TRANSFERS OF EXCHANGES BY LECS

The Commission itself acknowledged almost three years ago that the current study area waiver procedure "does not work well" in the context of arms-length sales of local exchanges.[12] Particularly in view of the impending substantial increase described above in the number of sales of LEC exchanges, it is imperative that the Commission act promptly to improve its process for addressing these transactions.

Although the paramount public interest issue raised by these transactions is their impact on USF growth, the Commission's current waiver criteria for sales of LEC exchanges are not sufficiently specific to satisfactorily resolve that issue. Because any given sale of exchanges typically results in an increase in USF payments of several hundred thousand dollars or less, the LECs have consistently contended that these transactions have no adverse impact on high cost support (and, thus, satisfy the Commission's waiver criteria) simply because the additional amounts are _de minimis_ relative to the

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[12] _Part 36 NPRM_, 5 FCC Rcd. at 5975-5976 (¶ 17).

total size of the USF. As the Commission itself has recently acknowledged, this argument imperils the objective of the study area boundary restriction:

> "The high cost fund has grown at a substantial and unanticipated rate in the past few years; taking the approach [that the additional costs are minimal when viewed in terms of the total fund] could result in its continued unbridled growth, since the increment to the USF associated with the sale of virtually any individual exchange could be characterized as '<u>de minimis</u>' in comparison to the nationwide total of some $700 million."[13]

To assure that sales of exchanges meet the requisites for a study area waiver (<u>i.e.</u>, that they will have "no adverse effect" on the USF and otherwise serve the public interest), the Commission should require both

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[13] <u>See</u>, <u>e.g.</u>, <u>U S WEST Communications, Inc. and Wiggins Telephone Association (Joint Petition for Waiver)</u>, Memorandum Opinion and Order, DA 93-887, released August 10, 1993 ("Wiggins Telephone"), ¶ 6. <u>See also</u> <u>Island Telephone</u>, 7 FCC Rcd. at 6382 (¶ 4)(noting that where a high cost local exchange purchase increased the LEC's annual amount of USF subsidy increased from $15,000 to $29,000, "the dollar amount may be small, [but] the change is significant").

In <u>Wiggins Telephone</u>, the Commission allowed the waiver request because it found that the transfer was "a properly justifiable addition to the subsidy fund" in light of service improvements planned by the LEC purchaser. <u>Id.</u>, ¶¶ 6-8. Additionally, the Commission conditioned the transfer on the acquiring LEC's agreement to cap the amount of the USF increase at its initial additional level for three years following the sale. <u>Id.</u>, ¶ 10. While AT&T endorses the Commission's decision to cap the amount of the USF increase resulting from a given transfer, that limitation does not fully alleviate the ongoing increase in the support fund's size caused by continued waivers of the study area boundary restriction.

the LECs selling and purchasing a local exchange to satisfy specific criteria before obtaining Commission approval of those transactions. First, each LEC purchasing an exchange should be required to submit to the Commission, and place on public file, an estimate of the impact of that transaction on its eligibility for high cost support and, if applicable, on the amount of additional subsidy it will receive from the USF. These projections should be sufficiently detailed to permit the Commission and interested parties to independently verify the carrier's estimate of the USF impact of the acquisition.[14]

Second, the Commission should require the purchaser and seller to furnish the Commission, as part of their public filing, with detailed information regarding the valuation of the exchange assets included in the transaction. The following specific information should be required of the parties to the transaction:

- The book value of the plant being sold;
- The date of installation, and depreciation rate, of that plant;

[14] For cost study LECs, the level of detail in the carrier's filing should be the same as that required by the Universal Service Fund Data Collection Form submitted by those carriers to the National Exchange Carrier Association ("NECA"). For sales of exchanges to average schedule companies, NECA should be required to estimate the impact on the USF resulting from such sales.

- The subscriber plant factor ("SPF") of loop assets being sold;

- The dial equipment minutes ("DEM") factor of any switches being sold, and the DEM factor (weighted) of the buyer.

- The depreciation reserves of all assets in the transaction (together with a showing that continuing property records are maintained).

- The number of miles of subscriber loop plant being sold.

- The excess deferred taxes for the assets being sold.

- Pro-forma revenue requirement calculations, pre- and post-sale.

- The accounting plans of the buyer to book the purchase price and construction costs.

- Whether the buyer intends to request waiver of Section 32.2005 (establishing book value as amount to be written above the line for inclusion in rate base).

- Any outstanding state commission order or plan that creates an obligation on the selling LEC to upgrade or extend existing service.

- The extent to which the selling LEC's current rates are based on these obligations; and

- If applicable, the construction and investment plan of the buyer that will accomplish the upgrading and extension mentioned in the petition.

These data form the underlying basis for, and allow analysis of, the costs on which the carrier's projection of the sale's impact on the USF is based. Such basic information is critical to the Commission's informed determination whether the proposed transaction is, in fact, "a properly justifiable addition" to the USF fund in light of all factors bearing on that sale.[15]

Third, the purchaser of an exchange should be required to demonstrate the extent to which local ratepayers will assume the cost burden of any planned upgrades in service, which otherwise could be borne primarily by access ratepayers contributing to the high cost fund. Under the current waiver process, the Commission has sometimes cited a carrier's efforts to recover these added costs through local rates as one factor warranting grant of the petitioners' application.[16] There is no apparent basis, however, for exempting <u>any</u> LEC purchasing an exchange from the obligation to balance an increase in high cost payments with a meaningful contribution to those added costs from local ratepayers who will also benefit from service upgrades related to the sale transaction.[17]

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[15] <u>Wiggins Telephone</u>, <u>supra</u>, ¶ 6.

[16] <u>See</u> <u>Gila River</u>, 7 FCC Rcd. at 2162 (¶ 11).

[17] Moreover, even where the LEC makes such a showing, the Commission should as a matter of course follow its precedent in <u>Wiggins Telephone</u> by temporarily capping the amount of the acquirer's additional USF support at the initial level before the carrier undertakes any upgrades to that exchange. As the Commission pointed out there, such a procedure will help to assure that "the [USF] is protected from unrestrained demands" resulting from LEC purchases of high cost telephone exchanges <u>Id.</u>, ¶ 10.

Further, any transaction that includes as one of its components the addition of the newly acquired exchange(s) to the NECA traffic sensitive ("TS") pool should include a detailed explanation of the anticipated impact on those rates and a full description of the basis for that calculation. NECA itself has already expressed considerable concern regarding the current disparity between its TS rates and those of non-pool LECs, and the likelihood that this disparity will create incentives for bypass of rural carriers.[18] Insofar as the large future volume of sales of local exchanges may further exacerbate this potential problem, the Commission should take these consequences into account when evaluating whether requests to implement those transactions satisfy the

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[18] NECA described this situation as follows in its recent annual access tariff filing:

> "Absent an alternative that would reduce the traffic sensitive rate disparity, larger exchange carriers will continue to have an incentive to exit the voluntary T/S Pool and remaining pool members will face higher rates and increased risk of bypass. For example, the 1993/1994 pool composition reflects two large study areas (over 50,000 lines) and five medium size study areas (over 20,000 lines) exiting the pool due to this rate disparity. These study areas were significant contributors to the T/S Pool ($40.2 million in 1992)."

NECA April 2, 1993 Tariff Filing, Volume 1, p. 6 n.12.

public interest criterion of the Commission's waiver analysis.[19]

CONCLUSION

For the reasons stated above, the Commission's current waiver criteria for addressing sales of high cost local exchanges should be made more specific to protect the important public interest in checking the continued growth of the USF. Accordingly, the Commission should initiate a rulemaking to adopt such additional standards for evaluating such sales, as described in AT&T's foregoing petition.

Respectfully submitted,

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19 One means for the Commission to avoid creating additional incentives for bypass and toll rate deaveraging by rural LECs' access customers would be to preclude entry into the NECA TS pool of high cost rural exchanges purchased by a LEC, where that transaction would otherwise create upward pressure on NECA's TS rates.